



Are Retail REITs the Next Big Short?

Description

The retail industry's death by **Amazon.com, Inc.** ([NASDAQ:AMZN](#)) continues to garner considerable attention as the volume of bankruptcies and decline of traditional brick-and-mortar retailers grows. There are signs that department stores could very well be facing extinction. This coupled with Amazon's renewed assault on groceries and fresh food is placing grocery stores under pressure. The fallout isn't limited solely to the retail industry — another industry that is feeling the heat is retail real estate investment trusts, or REITs.

You see, major department store chains have long been key anchor tenants for shopping malls, and their demise signals that demand for floorspace is declining.

Now what?

This means that retail REITs will become more dependent on smaller brick-and-mortar retail businesses, which are more volatile and less likely to lock in long-term rental agreements.

Then there is the concern that Canada has too many shopping malls, which, coupled with declining demand, is leading to overcapacity. Just like in the U.S., there was a frenzied expansion of shopping malls over the last three decades. This now sees Canada ranked second behind the U.S. for gross leasable area per capita of just over 16 square feet or 48% more than Australia, more than triple the U.K., and almost five times higher than France.

The loss of major anchor tenants such as department stores will trigger a ripple effect through shopping malls. This is because many smaller tenants have co-tenancy clauses in their rental agreements giving them the right to break their lease if an anchor tenant leaves. All tenants are also pushing for shorter leases, reducing the dependability of earnings for retail REITs.

In this environment, many retailers are willing to close marginally profitable stores rather than risk having them become loss making and a liability, particularly if an anchor tenant leaves, causing foot traffic to decline sharply.

The confluence of these factors means that the failure of an anchor tenant, such as Sears Canada

Inc., which declared bankruptcy in June, can ultimately close a mall.

So what?

For these reasons, REITs that are focused on or have a large exposure to retail properties are coming under considerable pressure.

Canada's largest diversified REIT **RioCan Real Estate Investment Trust** ([TSX:REI.UN](#)), which derives a third of its earnings from retail, has seen its stock fall by 9% over the last year because of the headwinds facing brick-and-mortar retailers. This is because a number of department store chains, which have been bearing the brunt of Amazon's onslaught, are among its top 10 tenants by revenue.

Retail REIT **Choice Properties Real Estate Investment Trust** ([TSX:CHP.UN](#)), which has a portfolio of 537 retail properties across Canada, is also vulnerable to the dramatic shift underway because of the growth of e-commerce. It has proven to be relatively resilient to the fundamental changes triggered by the growing popularity of online retail, because its largest tenant by revenue is grocery and fresh food retailing giant **Loblaw Companies Ltd.**

Nonetheless, Amazon's renewed foray into the groceries and fresh food segment as well as the declining demand for brick-and-mortar space makes it likely that it will come under pressure in coming months. That has seen its price drop by 4% over the last year and stymied its growth potential for the foreseeable future.

Another retail REIT under considerable pressure is **Partners Real Estate Investment Trust** (TSX:PAR.UN). Its stock has declined by almost 10% over the last year because of the impact of Sears filing for bankruptcy, which was among its top 10 tenants and was responsible for 4% of its leased square feet. Sears had also been an anchor tenant at Partners's Ontario Cornwall enclosed mall.

The headwinds facing the retail industry indicate that retail REITs could indeed be the candidate for the next big short, with many likely to come under considerable pressure because of rising retail bankruptcies and higher interest rates.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NASDAQ:AMZN (Amazon.com Inc.)
2. TSX:CHP.UN (Choice Properties Real Estate Investment Trust)
3. TSX:REI.UN (RioCan Real Estate Investment Trust)

PARTNER-FEEDS

1. Msn
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